PRICEWATERHOUSECOOPERS

PREMERA

Exhibit 1

Report on Tax Matters in Connection with The Washington Foundation Shareholder and The Alaska Health Foundation

CONFIDENTIAL INFORMATION

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February 28, 2004

Prepared for the Washington Office of the Insurance Commissioner

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PREMERA CONVERSION TRANSACTION

Re: Considerations Regarding the Tax Status of the Entity (or Entities) to be Utilized to Accept and Sell the Shares of New Premera and To Invest and Deploy the Proceeds to Promote the Health of the Residents of the States of Washington and Alaska

I. Executive Summary

A. Premera Proposal

Consistent with the historic nonprofit purpose of many health plans, and to avoid the expense of potentially significant federal income taxes, it has become the custom of the parties to "Blues Conversion" type transactions to form an entity (or entities) designated to accept, manage, and deploy the resulting funds to benefit public healthcare organizations that are exempt from federal income tax. The 2004 Premera Conversion Transaction Plan (the "Premera Conversion Plan," "Conversion Plan" or "Plan") also proposes the formation and use of two such entities, the Washington Foundation Shareholder ("WA Foundation") and the Alaska Health Foundation ("AK Foundation"), each intended to qualify for federal income tax exemption. Each organization is intended to qualify for exemption as a "social welfare organization" described in Code section 501(c)(4)*. Each would accept an allocated share[1] of all of the outstanding common stock of New Premera from Premera (and, possibly, contributions of cash or other property from Premera or New Premera) which would be earmarked to be used to accomplish objectives and purposes consistent with the purposes set forth in each organization's Articles of Incorporation. In the case of the WA Foundation, this would include the ability, as set forth in its proposed Articles of Incorporation, to devote no more than an insubstantial part of its activities to attempting to influence legislation, so long as no amount of the proceeds from the sale of the stock of New Premera (or investment income derived therefrom) is used to influence any legislation and, without regard to the source of the funds, no amount is used to influence legislation that may result in a material adverse change in the operations of any entity providing health insurance or otherwise in the business of providing coverage of health benefits or the administration of health benefits. (There are comparable provisions in the Articles of Incorporation of the AK Foundation.)

It is important to note that it is believed that the gain from the sale of the New Premera Shares will be approximately equal to the net proceeds from such sale. Unless the entity that sells the Shares is exempt from federal income tax, such gain will be subject to federal income tax at a rate as high as 35%. Accordingly,

* All Code or section references are to the Internal Revenue Code of 1986, as amended, unless otherwise indicated.
[1] The appropriate allocation of shares between the Washington Foundation and the Alaska Foundation has not yet been determined.

the Plan of Conversion at Paragraph 4.3(a)(IV)(A) requires that the WA Foundation "have received (or applied for) a determination letter from the Internal Revenue Service that it is exempt from taxation under section 501(a) of the Code" prior to the consummation of the Conversion. (There is a comparable provision in the Plan of Conversion regarding the AK Foundation.)

It is also important to note that in the event that the WA Foundation is determined to be exempt from federal income tax under section 501(a) of the Code by reason of being a "private foundation" described in sections 501(c)(3) and 509(a) of the Code, the gain from the sale of the New Premera Shares would be subject to federal excise tax (at a rate as high as 2%) under section 4940 of the Code. On the other hand, if the WA Foundation is determined, as it would seek, to be exempt from federal income tax under section 501(a) of the Code by reason of being described in section 501(c)(4) of the Code no such federal excise tax would be applicable.

Inherent in the Plan as it relates to the formation and use of these federally tax-exempt organizations are certain intended advantages and related disadvantages. Specifically, the significant advantages of the Plan as proposed would be:

1. No federal income tax would be incurred upon the receipt of the New Premera Shares from Premera by either the WA Foundation or the AK Foundation;

2. No federal income tax would be incurred on the gain from the sale of the New Premera Shares by either the WA Foundation or the AK Foundation;

3. No federal income tax would be incurred by either the WA Foundation or the AK Foundation on the income earned by investing the net proceeds derived from the sale of the New Premera Shares;

4. No federal excise tax (generally imposed on "private foundations" at the rate of 2% on its "net investment income," including capital gains) would be imposed on the gain from the sale of the New Premera Shares by either the WA Foundations or the AK Foundation or on the income derived from investing the sale proceeds. (Nor would either the WA Foundation or the AK Foundation be required to comply with certain other restrictions and requirements imposed on "private foundations," including certain mandatory minimum distribution requirements.)

The significant disadvantages that could or would result from the implementation of the Premera Conversion Transaction Plan as it relates to the formation and use of the two exempt organizations are as follows:

1. If a reasonable degree of tax certainty is an objective to be achieved it may be necessary to delay the distribution of the New Premera Shares to the WA Foundation or the AK Foundation until the IRS recognizes that each

Foundation is exempt from federal income tax by reason of being described in Code section 501(c)(4). This could take as few as three months to as many as twelve months or longer from the time that each Foundation is formed, partially funded and applies for recognition of its intended federal tax status. As noted above, the Plan requires as a condition of consummation of the proposed conversion that each of the Foundations have received (or applied for) a formal determination by the IRS that it is an organization described in Code 501(c)(4). The most likely reason why the IRS would delay or decline to recognize the WA Foundation or the AK Foundation as an organization described in section 501(c)(4) of the Code would be the IRS conclusion that these organizations are more accurately recognized as "private foundations" described in sections 501(c)(3) and 509(a) of the Code.

2. If, as it intends to request, the WA Foundation is recognized for federal income tax purposes as described in section 501(c)(4) of the Code, individuals, corporations or other entities making contributions to the WA Foundation would not be entitled to a charitable contribution deduction for either federal income tax, federal estate tax or federal gift tax purposes. This could have a material affect on the WA Foundation's ability to attract additional financial resources from third parties although there is no expressed intention to seek such additional financial resources.

3. If, as it intends to request, the WA Foundation is recognized for federal income tax purposes as described in section 501(c)(4) of the Code, other organizations that have been recognized as "private foundations" and that regularly make grants to support the improvement of public health may be reluctant to make grants to the WA Foundation or to collaborate with the WA Foundation on joint projects. Similarly, as an organization described in section 501(c)(4) of the Code, the WA Foundation may not qualify as a potential grant recipient under certain Federal or state grant programs that require the grantee to be an organization described in section 501(c)(3) of the Code.

4. As a general rule, the public and most governmental authorities (other than the Internal Revenue Service) have greater confidence in and respect for an organization that has been recognized as exempt from federal income tax by reason of being described in section 501(c)(3) of the Code than an organization that has been recognized as exempt by reason of being described in section 501(c)(4) of the Code, but subject to a lesser degree of IRS scrutiny.

B. Alternatives

Although a number of "Blues Conversion" type transactions have occurred in the past 10 years, no pattern of "best practices" from a tax-perspective appears to

have surfaced as such transactions relate to establishing one or more organizations to hold and deploy, for the benefit of the public, the value of funds created upon the sale of these nonprofit insurance businesses.

Many foundations established as a result of healthcare conversion transactions have been recognized for federal tax purposes as private foundations. A lesser number have been recognized as social welfare organizations. The following chart, "A Profile of New Health Foundations" details the tax-exempt status of recent health plan conversion organizations.

A Profile Of New Health Foundations Health Plan Conversions

State, Name, and Web Address	Year of Conversion	Current Assets 2001	IRS Tax-Exempt Status	Grant Making Focus
California				
The California Endowment Woodland Hills, CA www.calendow.org	1996	$2,887,000,000	Private Foundation 501(c)(3)	Access to health and related services for underserved individuals and communities; improvements in health status; cultural competency; health disparities; workforce diversity
California HealthCare Foundation Oakland, CA www.chcf.org	1996	$723,000,000	Social Welfare Organization 501(c)(4)*	Health care delivery; business practices in health care; health policy
Alliance Healthcare Foundation San Diego, CA www.alliancehf.org	1994	$74,000,000	Private Foundation 501(c)(3)	Access; substance abuse; communicable disease; violence prevention; mental health services; environmental and community health
The California Wellness Foundation Woodland Hills, CA www.tcwf.org	1992	$985,910,600	Private Foundation 501(c)(3)	Diversity in health professions; environmental health, healthy aging; womens' health; mental health; teen pregnancy prevention; violence prevention, work and health
COLORADO				
Caring for Colorado Foundation Denver, CO www.caringforcolorado.org	1999	$130,000,000	Social Welfare Organization* 501(c)(4)	Infrastructure; emerging community issues; enabling informed health decisions
CONNECTICUT				
Connecticut Health Foundation Farmington, CT www.cthealth.org	2001	$130,000,000	Private Foundation 501(c)(3)**	Oral health; children's mental health; racial and ethnic health disparities
Anthem Foundation of Connecticut West Hartford, CT www.anthemfdnct.org	1999	$44,000,000	Pubic Charity 509 (a)(3) supporting organization	Health care financing; quality care/compliance; community empowerment

State, Name, and Web Address	Year of Conversion	Current Assets 2001	IRS Tax-Exempt Status	Grant Making Focus
DISTRICT OF COLUMBIA				
Consumer Health Foundation Washington, DC www.consumerhealthfdn.org	1994	$31,013,487	Private Foundation 501(c)(3)	Health status improvement; consumer involvement in their own health; access to health care, including primary care, prevention, health promotion, and AIDS services; capacity building; vulnerable populations; health disparities.
GEORGIA				
Healthcare Georgia Foundation Atlanta, GA. www.healthcaregeorgia.org	1999	$117,000,000	Private Foundation 501(c)(3)	Health disparities; organizational improvement of health-related nonprofit organizations; access to primary care
KANSAS				
The Sunflower Foundation Topeka, KA www.sunflowerfoundation.org	2000	$79,000,000	Public Charity 509 (a)(3) supporting organization	Access to health care (health insurance, safety net, workforce); disease prevention and health promotion (obesity, tobacco use); aging (access to prescription drugs for low-income elderly, caregiving, resident-directed care); and mental health
KENTUCKY				
Foundation for a Healthy Kentucky Louisville, KY www.healthyky.org	2001	$46,500,000	Public Charity 509 (a) (1) traditional	Health education and prevention focused on children and families; access to health care and services
MAINE				
Maine Health Access Foundation, Inc. Augusta, ME www.mehaf.org	2000	$81,000,000	Private Foundation 501(c)(3)	Affordable and timely access to comprehensive quality health care; strategic solutions to health care needs, particularly for the medically uninsured and underserved.
MASSACHUSETTS				
The Health Foundation of Central Massachusetts, Inc. Worcester, MA www.hfem.org	1995	$47,000,000	Social Welfare Organization* 501(c)(4)	Oral health; mental health; child abuse treatment and prevention

State, Name, and Web Address	Year of Conversion	Current Assets 2001	IRS Tax-Exempt Status	Grant Making Focus
MISSOURI				
The Missouri Foundation for Health St. Louis, MO www.mffh.org	2000	$830,000,000	Social Welfare Organization* 501(c)(4)	Improving health and filling gaps in health services
NEW HAMPSHIRE				
Endowment for Health, Inc. Concord, NH www.endowmentforhealth.org	1999	$71,500,000	Private Foundation 501(c)(3)	Oral health; economic, geographic, and social/cultural barriers to accessing health and health care
Healthy New Hampshire Foundation Concord, NH	1997	$13,500,000	Private Foundation 501(c)(3)	Health insurance coverage; health promotion
NEW MEXICO				
Con Alma Health Foundation Santa Fe, NM www.conalma.org	2001	$15,000,000	Private Foundation 501(c)(3)	Health and health-related projects
NEW YORK				
Community Health Foundation of Western New York and Central New York Buffalo, NY	2001	$45,000,000	Private Foundation 501(c)(3)	Access; improved quality; underserved populations; the uninsured; children; elderly
OHIO				
The Health Foundation of Greater Cincinnati Cincinnati, OH www.healthfoundation.org	1997	$260,000,000	Social Welfare Organization 501(c)(4)	Strengthening primary care providers to the poor; school-based child health interventions; substance abuse; severe mental illness
The Anthem Foundation of Ohio Cincinnati, OH www.greatercincinnatifdn.org	1995	$26,882,000	Public Charity 509 (a)(3) supporting organization	Preventive oral health care; family violence prevention programs for indigent populations
Columbus Medical Association Foundation Columbus, OH www.cmaf-ohio.org/cmaf	1992	$70,000,000	Public Charity 509 (a)(1) traditional	Access to health care; health education; health promotion
OREGON				

State, Name, and Web Address	Year of Conversion	Current Assets 2001	IRS Tax-Exempt Status	Grant Making Focus
Community Health Partnership Portland, OR www.community.oregonlive.com	1997	$1,562,000	Public Charity 509 (a) (3) Supporting Organization	Public health; graduate scholarships; public health workforce development; urgent needs in public health system
Northwest Health Foundation Portland, OR www.nwhf.org	1997	$65,000,000	Social Welfare Organization 501(c)(4)*	Rural health; access; mental health; children; youth; disease-related projects

* These 501(c)(4) organizations, often under pressure from consumer groups concerned about governance, accountability and transparency and sometimes pursuant to state statute, have adopted by-laws containing 501(c)(3) private foundation restrictions, such as prohibition against private inurement and self-dealing transactions, prohibitions on certain types of loans, and minimum payout requirements (although some permit the board in certain circumstances (e.g. bear markets) to make qualifying distributions that are less than the approximately five percent of endowment required of 501(c)(3) private foundations. The Health Foundation of Central Massachusetts initially incorporated as a 501(c)(3) but changed to a 501(c)(4) with restrictions in order to gain greater flexibility in pursuing public policy goals.

** This 501(c)(3) private foundation was originally incorporated as a 501(c)(4) social welfare organization with by-laws incorporating 501(c)(3) restrictions. In July 2002, it incorporated as a 501(c)(3), as required by the state attorney general.

Pre-1992 Health Foundations Health Plan Conversions

State, Name, and Web Address	Year of Conversion	Current Assets 2001	IRS Tax-Exempt Status	Grant making Focus
Michael Reese Health Trust Chicago, IL www.fdncenter.org/grantmaker/health	1991	$80,178,543	Private Foundation 501(c)(3)	Health care; health education; limited health research, primarily for public policy and advocacy
Prime Health Foundation Kansas City, MO www.primehealthfoundation.org	1989	$7,000,000	Private Foundation 501(c)(3)	Managed care; health care education; disease management
Archstone Foundation Long Beach, CA www.archstone.org	1985	$105,802,818	Private Foundation 501(c)(3)	Health and well-being of the elderly and their caregivers
Greater St. Louis Health Foundation St. Louis, MO	1985	$4,200,000	Private Foundation 501(c)(3)	Health care providers; health promotion and illness prevention; seed money for new projects
Georgia Health Foundation Atlanta, GA www.gahealthfdn.org	1985	$7,500,000	Private Foundation 501(c)(3)	Access; service delivery; health maintenance; public awareness; education; quality; evaluation; clinical research; preventive care
The Health Foundation of Greater Indianapolis, Inc. Indianapolis, IN www.thfgi.org	1984	$25,573,540	Private Foundation 501(c)(3)	HIV/AIDS (advocacy, prevention); adolescent/child health (access to primary care, school-based health); elder health (advocacy)
Sierra Health Foundation Sacramento, CA www.sierrahealth.org	1984	$125,000,000	Private Foundation	Capacity building; children's health; other health-related programs

The data in these charts is compiled from a May 2003 report published by Grantmakers in Health, A Profile of New Health Foundations, and from interviews with health foundation executives.

At least three models to minimize potential federal tax liabilities associated with the sale of the New Premera Shares and investment and deployment of the proceeds deserve consideration:

1. Section 501(c)(4) Social Welfare Organization: The 2004 Premera Conversion Plan would establish a new Washington nonprofit corporation (the "WA Foundation") and a new Alaska nonprofit corporation (the "AK Foundation"), in each case, organized so as to qualify as exempt from federal income tax by reason of being a "social welfare organization" described in section 501(c)(4) of the Code.

   As a "social welfare organization" described in section 501(c)(4) of the Code, the WA Foundation (as well as the AK Foundation) would not be subject to federal income or excise tax on: a) receipt of its share of the stock of New Premera; b) receipt of a contribution of cash or property (whether or not appreciated) from New Premera, Premera or any other person; c) gain realized upon the sale of stock of New Premera; d) gain realized upon the sale of any other property to the extent such property is not debt financed; and, e) receipt of dividends, interest, rents or royalties (whether derived from investing the proceeds from the sale of stock of New Premera or otherwise) to the extent that the property giving rise to such investment income is not debt financed.

   This model would promote simplicity by eliminating the need for tax purposes for either Washington or Alaska to form or maintain more than one tax exempt organization. Moreover, the annual federal tax information requirements imposed on a "social welfare organization" are materially less burdensome than those imposed on a "charitable private foundation" or even a "public charity."

   There are several possible disadvantages to this model (which may also be applicable in the case of a section 501(c)(4) Foundation Shareholder in the two-tier model described below). First, it may prove difficult to obtain recognition of federal tax exemption in the case of a social welfare organization that limits its ability to engage in political campaign and lobbying activities to the same extent as the limitations statutorily imposed on section 501(c)(3) charities. (This is because this is one of the principal differences for tax purposes between a "charitable" organization and a "social welfare" organization.) This issue exists, even though, as the chart profiling healthcare conversion foundations indicates, some states have formed social welfare organizations with by-laws that contain section 501(c)(3) restrictions. Second, the resulting organization may not qualify to receive grants that may otherwise be available under certain federal government programs and/or the guidelines of certain large independent private foundations.

2. Section 501(c)(3) Private Foundation: Were it to be determined preferable for non-tax reasons that the organization to ultimately hold and deploy the funds created from the sale of the New Premera Shares should be a "charitable" organization for federal income tax purposes, consideration should be given to establishing only a section 501(c)(3) "charitable" organization. Such a model would have the same federal income tax advantages as would be the case in model 1 above where the WA Foundation and the AK Foundation are organized as section 501(c)(4) social welfare organizations. In addition, individuals or corporations wishing to make a contribution of cash or property to the WA Foundation (and the AK Foundation) would be entitled to a charitable tax deduction for federal income, estate and gift tax purposes. Other charitable organizations and government agencies may find it more appropriate, (or even possible where it might not otherwise be) to contribute to or collaborate on projects with the WA Foundation were it organized as a section 501(c)(3) charitable private foundation.

   This model would be more complex for federal tax purposes than model 1 discussed above for two reasons. First, in general the federal tax rules and regulations governing charitable organizations described in section 501(c)(3) are more numerous and more complex than those governing social welfare organizations described in section 501(c)(4) of the Code. The number and complexity of such rules and regulations is significantly greater yet in the case of section 501(c)(3) charities that are classified as "private foundations," as would be the likely classification of the WA Foundation (and the AK Foundation). Second, the annual federal tax information reporting requirements of a section 501(c)(3) private foundation are significantly greater than those required of a section 501(c)(4) social welfare organization.

   The most significant tax disadvantage to this model results from the fact that the WA Foundation (and the AK Foundation) would likely be classified as "private foundations" if recognized as a section 501(c)(3) organization. As such there would be imposed on the WA Foundation (and the AK Foundation) a federal excise tax (at a rate as high as 2%) on the gain realized (likely, the net proceeds) from the sale of the stock of New Premera. In addition, there would be a similar excise tax on any gain realized upon disposition of other property (whether or not capital gain and whether or not long or short term) as well as on any dividends, interest, rents, royalties or other earned investment income. In addition, the WA Foundation (and the AK Foundation) would be required to annually make minimum distributions in furtherance of its purposes (even though there was neither cash nor income to support such distributions) and would have certain additional statutory restrictions imposed upon them.

3. Former Two-Tier Plan Model: The 2003 Premera Conversion Plan would have utilized a single section 501(c)(4) Foundation Shareholder to avoid the imposition of a private foundation excise tax (at the rate of as much as 2%) on the gain from the sale of the New Premera Shares. It would have also used a single section 501(c)(4) Foundation Shareholder to achieve certain objectives and purposes consistent with promoting the welfare of the citizens of both the States of Washington and Alaska. In addition, it was intended that it could have assisted with the coordination of the respective interests of Washington and Alaska in the Stock of New Premera until and in connection with their sale as contemplated by the Conversion Plan. Ultimately, under this model, Washington's share of the proceeds from the sale of the New Premera Shares would be distributed to a Washington Charitable Trust, an organization that for federal income tax purposes would be classified as a "charitable private foundation." (As such, its net investment income would be subject to an excise tax, at a rate of as much as 2%; it would be required to distribute annually in grants (and certain other "qualifying distributions") no less than 5% of the prior year's value of its assets; and, there also would be certain restrictions on its grant making ability.)

   The significant advantage of this model would be the potential to avoid federal excise tax (at a rate as high as 2%) on the gain (likely to be the net sale proceeds) from the monetization of the stock of New Premera while for the long term preserving the advantages of being classified a section 501(c)(3) charitable organization, albeit, a "private foundation."

   There are three significant disadvantages to this model. First, if a reasonable degree of tax certainty is an objective to be achieved it may be necessary to delay the distribution of the New Premera Shares to the Foundation Shareholder until the IRS recognizes that the Foundation Shareholder is exempt from federal income tax by reason of being described in Code section 501(c)(4). This could take as few as three months to as many as twelve months or longer from the time that the Foundation Shareholder is formed, partially funded and applies for recognition of its intended federal tax status. (The most likely reason why the IRS would decline to recognize the Foundation Shareholder as an organization described in Code section 501(c)(4) would be the IRS conclusion that the primary purpose of the Foundation Shareholder is to act as an intermediary with respect to the New Premera Shares, notwithstanding the fact that it will also engage in activities consistent with promoting the welfare of the citizens of the States of Washington and Alaska.) Second, from an exempt organization perspective, this model is complex. The formation, maintenance and operation of the three exempt organizations that would be created by the Plan would require significant coordination and resources. Moreover, it may be difficult to provide clear and understandable explanations for the reasons the organizations exist,

the relationship between and among the three organizations and, the differences in the tax requirements to maintain each. Third, to the extent that many of the advantages of having the ultimate holder of the proceeds from the monetization of the stock of New Premera be a section 501(c)(3) charitable organization can be achieved without having the organization formally so recognized by the Internal Revenue Service (as would appear to be the case under the first model) it is disadvantageous to be required to accept many of the burdens and restrictions of being a section 501(c)(3) "private foundation" that are not viewed fundamental or important to accomplish the plan.

Correspondingly, in order to obtain and retain its exemption from federal income tax as a charitable private foundation its governing instruments would need to make it clear that it could not and would not engage in or fund, directly or indirectly, any activities constituting campaigning for or against a candidate running for public office or lobbying a legislative body to do anything other than something that is non-partisan and/or that would directly affect the organization itself.

There follows a more detailed explanation and analysis of the considerations addressed in this executive summary, as well as some additional issues not relevant to an overview.

II. Overview of The Internal Revenue Code Regulation of Tax-Exempt Organizations

Under the Code there are more than thirty (30) different types of tax-exempt organizations. Foundations and other entities that receive assets from the conversion of a non-profit healthcare organization can operate under several different tax exempt status categories. The type of tax status permitted or recognized by the IRS will not only reflect the purpose and activities of the organization but will affect its governance, operations, and reporting requirements, both directly and indirectly.

Section 501(a) of the Code confers exemption from federal income tax on a wide variety of entities. By far the most prevalent type of exempt organizations are charitable organizations described in section 501(c)(3), which can be either private foundations or public charities, and, in either case, are eligible to receive tax deductible contributions. The next most common are social welfare organizations which, although tax-exempt, are very limited in their eligibility to receive tax-deductible contributions.

The Code does not treat tax-exempt organizations uniformly; for example, it imposes varying prohibitions against self-dealing and political campaign activities, and different degrees of limitation on lobbying, depending on the exempt organization's classification as a private foundation, public charity or social welfare organization. Nor are tax-exempt organizations divided, as under state law, according to the organizational nature of the

entity--trust, corporation or unincorporated organization. Instead, they are categorized not only on the basis of their purposes and activities, but also according to the sources of their financial support.

A tax-exempt entity may be a section 501(c)(3) private foundation (with an endowment from a single source and many organizational and operational restrictions) or a section 501(c)(3) public charity (typically, with funding from the general public and subject to fewer restrictions) or a section 501(c)(4) social welfare organization. To justify the privilege of receiving tax-exempt status, the Code requires that all three types:

- must serve a public rather than a private purpose;
- must not be operated for the private or personal benefit of designated individuals or the founders; and
- must engage primarily in activities that further the identified charitable or social welfare purpose.

III. Section 501(C)(3) Charitable Organizations

A. Basic Requirements for Exemption

Definition. section 501(c)(3) entitles entities organized exclusively for religious, charitable, scientific, testing for public safety, literacy or educational purposes to be exempt from most federal taxes. (The enumerated public purposes also include fostering national or international amateur sports competition or preventing cruelty to children or animals.) Many states, honoring this designation, confer similar exemptions for state and local taxes.

To obtain tax-exempt status, section 501(c)(3) requires that:

1. an organization be both organized and operated exclusively to further a proper exempt purpose;
2. no part of the net earnings of the organization inures to the benefit of any private shareholder or individual;
3. no substantial part of the organization's activities consists of carrying on propaganda or otherwise attempting to influence legislation, or participating or intervening in any political campaign on behalf of or in opposition to any candidate for public office; and
4. the organization operates as a common-law charity.

The regulations interpret the Code provision requiring that a charity be organized "exclusively" for exempt purposes to mean "primarily" (Treas. Reg. 1.501(c)(3)-1(c)(1)). The promotion of health is considered to be a charitable purpose.

Requirements in the Organizing Documents. The practice among the majority of those who establish exempt organizations is to track the language in the Code and regulations in order to avoid controversy with revenue agents as to whether the organization will be eligible for exemption. To satisfy the organizational test under section 501(c)(3), properly drafted organizing documents should include the following:

1. A purpose clause, which limits the purposes of the organization to one or more exempt purposes described in section 501(c)(3);

2. A power clause, which limits the organization's activities to those that further its exempt purposes;*

3. A provision prohibiting private inurement and limiting private benefit;**

4. A dissolution clause, which dedicates the organization's assets solely to exempt purposes and ensures that on dissolution of the organization any remaining assets will be distributed for one or more exempt purposes or to one or more section 501(c)(3) exempt organizations or the federal or state government;

5. A provision prohibiting participation or intervention in a political campaign;

6. A provision limiting lobbying activity; and

7. Provisions relating to private foundation status and private foundation activity limitations.

Each of these clauses relates to a specific element of the organization's operation.

With respect to fiduciary duties, the Service objects to inclusion of broad exculpatory clauses on the grounds that they could excuse a trustee from any violations of the conditions for exemption.

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* The test will not be met if more than an insubstantial part of an organization's activities are not in furtherance of an exempt purpose. Exemption will be denied if the organization's governing documents include a provision expressly permitting it to engage in an activity that does not further its exempt purpose if the activity is more than an insubstantial part of operations.

** The proscription against private inurement applies to benefits that accrue only to "insiders", to persons who have an interest in the organization, such as directors, officers or employees. It applies only when the benefits conferred are not commensurate with the services or other value provided. Thus, it is not an absolute ban on self-dealing, but a standard based on reasonableness which can be substantiated by reference to the terms of an arms-length transaction. The sanction for the violation of the private inurement prohibition is loss of exemption.

The Operational Test. The operational test ensures that the determination of exemption will not be made solely on the basis of an organization's governing documents, but will require a showing that its on-going activities will meet and maintain the conditions for exemption. The hurdle of qualifying as a section 501(c)(3) organization must be met before an organization ever reaches the question of whether it is a public charity or private foundation.

B. Classification as a Private Foundation or Public Charity

The Code presumes a section 501(c)(3) charitable organization is a private foundation, unless it can demonstrate otherwise. Section 509(a) defines a private foundation by exclusion. The term "private foundation" is defined as any organization described in section 501(c)(3) other than the four categories of public charities excepted from private foundation status under section 509. In so doing, the Code divides tax-exempt section 501(c)(3) organizations into two basic classifications: private foundations and public charities.

Public charities include:

1. organizations conducting certain types of legislatively favored activities, such as churches, education (high schools, colleges or universities), hospitals or medical research organizations;

2. certain "publicly supported" organizations receiving a substantial amount of their support from the conduct of exempt function activities and gifts, grants and contributions from the general public or from governmental entities;

3. "supporting organizations" of other public charities excluded from private foundation treatment due to their exclusive operation for the benefit of, to perform the functions of or to carry out the purposes of one or more specified organizations that are not themselves private foundations; and

4. organizations whose exclusive function is testing for public safety.

Private Foundation Requirements. Private foundations, usually endowed from a single source, generally do not engage in operating charitable programs directly but instead make grants to other eligible non-profit organizations. They do not raise funds from the public. To qualify for exemption, a private foundation must provide in its governing instrument special provisions (in addition to those generally required of all section 501(c)(3) organizations under the organizational test) to the effect that it will at all times make distributions; avoid certain dealings with the trustees, officers, and other so-called disqualified persons; and avoid

certain investments, in each case, as required by rules mandated by Chapter 42 of the Code.*

Public Charities. By contrast, section 501(c)(3) charities that escape classification as a private foundation are subject to far fewer tax rules and less onerous annual tax reporting requirements.

Possible Classification of the WA Foundation as a Private Foundation. In the event that the WA Foundation is determined to be described in section 501(c)(3) of the Code, it is likely that it would be classified as a private foundation, not a public charity, because it would appear that it would not be able to satisfy either of the two "public support" tests or other requirements to be classified as a public charity. It is possible that the Internal Revenue Service will determine that the WA Foundation is described in section 501(c)(3) of the Code even though the Premera Conversion Plan seeks to have it determined to be described in section 501(c)(4) of the Code.

C. Restrictions on Private Foundations: Chapter 42 Rules

The Tax Reform Act of 1969 established a distinction between private foundations and public charities and imposed significant operating restrictions on private foundations. These mandate a duty of financial loyalty by prohibiting self-dealing, prevent unreasonable accumulations of income by imposing mandatory payout requirements, establish, in effect, a prudent investor rule for foundations by prohibiting the retention of excess business holdings and investment practices that jeopardize the foundation's ability to carry out its exempt purposes, and place limits on program activities and the process of grant making by taxing various types of prohibited expenditures, including lobbying (with a few exceptions) and electoral campaign activities. In addition, the Act imposes an annual excise tax (generally at the rate of 2%) on the "net investment income" including capital gains of a private foundation (as explained more fully below).

With the exception of the excise tax on jeopardy investment income and the penalties for self-dealing, violation of these rules results in the imposition of excise tax penalties on the foundation and on those foundation managers who knowingly approved the prohibited expenditure. Five sets of excise taxes exist, with each set entailing an initial tax, an additional tax, and an involuntary

* A private foundation's governing instrument is its articles of incorporation, not its bylaws, if it is a corporation; the trust instrument or agreement if it is a trust; and the articles of association if it is an unincorporated association. A private foundation will not qualify for exemption unless its governing instrument includes provisions that require the private foundation to comply with the minimum distribution requirements of section 4942 and that prohibit the private foundation from violating the other provisions of Chapter 42 relating to self-dealing (section 4941), excess business holdings (section 4943), jeopardy investments (section 4944), and taxable expenditures (section 4945). Excise tax penalties are imposed for violating these requirements. By requiring these provisions to be included in a private foundation's governing instruments, state law remedies (e.g., surcharging directors or trustees) can be invoked as well as the excise taxes themselves.

termination of tax exempt status if there continues to be repeated or willful violations. (The IRS has the authority to abate these initial taxes, except in the context of self-dealing, where the violation is due to reasonable cause and not to willful neglect, as long as the matter is timely corrected.)

1. Self-dealing. Section 4941 imposes a tax on various acts of self-dealing between a private foundation and a "disqualified person." An act of self-dealing may be direct or indirect. A "disqualified person" is statutorily defined to include foundation managers, substantial contributors to the foundation,* owners of more than 20% of the voting power of a corporation, the profit interest in a partnership or the beneficial interest in a trust that was a substantial contributor to the foundation, specified family members of any of these individuals, and corporations and other business entities in which any disqualified persons have more than a 35% interest in voting power, profits or beneficial interests, and elected public officials.

   Self-dealing transactions may include the following transactions between a private foundation and a disqualified person: the sale, exchange or leasing of property, the lending of money or other extension of credit, the furnishing of goods, services or facilities, the payment of compensation, the transfer to or use by or for the benefit of, a disqualified person the income or assets of the private foundation.

   A number of important exceptions exist, primarily in circumstances where no charge or remuneration is involved. An exception also exists for a transaction between a private foundation and a corporation that is a disqualified person.**

2. Mandatory Payout. Section 4942 requires a private foundation to distribute annually a minimum amount of money or property for qualified purposes. The minimum mandatory expenditure is an amount equal to five percent of the value of the prior year's noncharitable assets (roughly equivalent to its endowment). Qualifying distributions are essentially grants, outlays for administration***, and payments made to acquire charitable assets.

3. Excess Business Holdings. To maintain its independence and to ensure its decisions are not influenced by its financial holdings, a private foundation is prohibited under section 4943 from holding (directly or indirectly) more than

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* A substantial contributor is any person (including a corporation, partnership, trust or state) who has contributed more than $5,000 to the foundation if the total of his contributions exceeded 2% of the total contributions received by the foundation form its date of creation to the end of the year in which the $5,000 limit was met.

** It is not an act of self-dealing if the transaction occurs pursuant to a liquidation, merger, redemption, recapitalization, or other corporate adjustment, organization, or reorganization. (For this exception to apply, all the securities of the same class as that held by the foundation prior to transfer must be subject to the same terms and these terms must require receipt by the foundation of no less than fair market value.)

*** Proposed legislation would eliminate, in whole or in part, the ability to treat many administrative expenses as qualifying distributions.

20 percent of the voting stock of any corporation or 20 percent of the profit interest in any partnership. If effective control of the business can be shown to be elsewhere, a 35 percent limit may be substituted for the 20 percent limit (There is a 2 percent de minimus rule in the case of measuring indirect holdings by attribution).

Three exceptions exist: 1) for a business deriving at least 95 percent of its gross income from passive sources; 2) for holdings in a functionally related business—a business that is substantially related to the achievement of the foundation's exempt purposes, as long as certain other conditions exist (e.g., work is performed without compensation for the convenience of employees that consists of selling contributed merchandise, or that is carried on within larger aggregate of similar activities or endeavors that are related to the exempt purposes of the foundation; and 3) for program-related investments.

A foundation has a five-year grace period (and in certain circumstances involving the exercise of diligent efforts, an additional five years may be permitted) to diversify a portfolio or reduce the excess business holdings to permissible levels without incurring a penalty in cases where those excess holdings are received by gift or bequest.

4. Jeopardizing Investments. A tax is imposed by section 4944 on investments of a private foundation that are considered risky using a prudent investor standard. An investment is considered to jeopardize the carrying out of the foundation's exempt purposes if the foundation managers in making the investment, failed to exercise ordinary business care and prudence, under the facts and circumstances prevailing at the time of the investment, in providing for the long-term and short-term financial needs of the foundation in carrying out its charitable purposes. No category of investments is treated as a per se violation of these rules.

5. Taxable Expenditures. Unlike the restrictions described previously that involve violations of loyalty and care, the restrictions under section 4945 regulate the activities and charitable purposes for which private foundation managers may expend foundation's funds. These rules constrain or prohibit legislative activities, electioneering, grants to individuals, and grants to noncharitable organizations. Prohibited expenditures are deemed taxable expenditures.

The penalties for violations of section 4945 may be imposed on the foundation as well as its managers. Five categories of taxable expenditures exist and will subject the foundation and its managers to excise taxes if made (and potential involuntary termination of exempt status if continuing or not "corrected"):

- Propaganda and lobbying. Section 4945(d) prohibits foundations from expending any amount to influence legislation if it is for a

direct lobbying communication or a grass roots lobbying communications or efforts to affect the opinion of the general public. Attempts to influence legislation generally include communications with a member or employee of a legislative body or with an official or employee of a government executive department engaged in formulating legislation. (Thus, the general rule permitting other types of exempt organizations, such as public charities or social welfare organizations, to engage in legislative activities is inapplicable to private foundations). Three exceptions exist and are discussed in greater detail below at V., "Lobbying and Political Activities."

- Influencing the Outcome of an Election. Attempts to influence the outcome of a specific public election or to carry on a voter registration drive are taxable expenditures. This prohibition generally parallels the prohibition on political campaign activities by all charitable organizations. However, if certain criteria are met, a private foundation may engage in voter registration drives.

- Grants to Individuals. As a general rule, grants to individuals are not prohibited. However, Code section 4945(d)(3) defines as taxable expenditures grants to individuals for travel, study, scholarships or similar purposes if the foundation has not obtained advance approval from the IRS regarding the details of such grants.

- Grants to Other Foundations. As a general rule, a private foundation is limited in its ability to make a grant to another private foundation. Such grants are subject to excise tax unless the grantor foundation exercises "expenditure responsibility" for the duration of the grant, requiring the grantor foundation to investigate the potential grantee prior to making the grant and requiring the grantee to use the funds only for the purposes for which it was made, to comply with private foundation expenditure restrictions, and to provide progress reports. These are common grant making practices among many private foundations with professional staff. However, expenditure responsibility requires the grantor foundation to report to the IRS on the expenditures made by the grantee, an added administrative burden in excess of usual practice. There are no restraints on a private foundation's ability to make grants to a Code section 501(c)(3) public charity.

- Expenditures for Noncharitable Purposes. This prohibition applies to any grant to an organization that is not exempt under section 501(c)(3), unless certain conditions are satisfied.*

IV. Social Welfare Organizations Described in Section 501(c)(4)

A. Basic Requirements for Exemption

Definition. An organization may qualify for exemption from federal income tax as a "social welfare organization" under Code section 501(c)(4) provided it is not organized for profit, it is operated exclusively for the promotion of social welfare, and no private individual or organization benefits from the net earnings of the organization.

Requirements in the Organizing Documents. Federal income tax rules do not require any specific language to be included in a social welfare organization's governing instrument, but it is considered prudent to include a provision precluding the distribution of the organization's net assets to private individuals or organizations upon dissolution. A start-up organization may take one of two approaches when preparing its governing instruments above and beyond complying with specific state not-for-profit laws – a restrictive approach or a non-restrictive approach.

To ensure that the IRS will respect its tax-exempt status as a social welfare organization, the governing instrument should restrict the primary activities to those that further (in some way) the common good and general welfare of the people in the broad-based community (e.g., bringing about civic betterment and social improvements).**

The Operational Test. federal income tax rules provide broadly that a social welfare organization is operated exclusively for the promotion of social welfare if it primarily engages in promoting in some way the "common good and general welfare" of the people of the "community". (For example, if it focuses its activities primarily on improving the availability, efficiency, and quality of health care within the community.) Whether the community identified by an organization or the identified beneficiaries of that community are sufficiently

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* These conditions are: (1) the making of the grant constitutes a direct charitable act or program-related investment; 2) the grantor exercises "expenditure responsibility"; and 3) the grantee agrees to maintain the grant funds or other assets in a separate fund dedicated exclusively to exempt purposes.

** The organization should file with the Internal Revenue Service Form 1024, Application for Recognition of Exemption Under Section 501(a), and a conformed copy of its charter and by-laws, if any. This form requires detailed descriptions of the organization's past, present and planned activities. For example, the organization must itemize and describe each proposed activity, and rank the activities based on the relative time and other resources devoted to them. The form also requires disclosure of the organization's current-year balance sheet, and current and projected (generally a proposed two-year budget) income statements.

large targets of the organization's activities to avoid the prohibition of private benefit and to justify federal income tax exemption as a social welfare organization will be determined by the Internal Revenue Service based on all the facts and circumstances of each particular case. It is clear, however, that the Internal Revenue Service prefers that programs provide support to a broad-based community. There is no doubt that all of the citizens of any state constitute a broad enough class to satisfy this requirement.

Social welfare organizations do not face the same restrictions as private foundations (or even the lesser restrictions imposed on public charities) in pursuing lobbying and political campaign activities. In general, a social welfare organization may further its social welfare purposes by seeking legislation germane to its programs without jeopardizing its federal income tax-exempt status. It may also engage in political campaign activities so long as they do not constitute the organization's "primary" activity. (By contrast, no more than an "insubstantial part" of the activities of a Code section 501(c)(3) public charity can constitute lobbying and it is prohibited from engaging in any political campaign activities.)

B. Comparison with Section 501(c)(3) Organizations

1. Similarities.

   (a) Neither organization may be organized or operated for private gain;

   (b) Each is subject to taxation on its unrelated business income;

   (c) Neither may be operated for profit; and

   (d) The concepts of "social welfare" and "charity" may overlap in that the promotion of social welfare may qualify as a "charitable" purpose.

2. Distinctions.

   (a) A social welfare organization may engage in an unlimited amount of legislative lobbying so long as the subject matter of such lobbying efforts is related to the organization's exempt purpose. A social welfare organization may engage in political campaigns in support of or opposition to a political candidate so long as its "primary" activity is the promotion of social welfare. A Code section 501(c)(3) organization may only engage in lobbying to the extent that such activities are an "insubstantial part" of its total

activities and is prohibited from engaging in any political campaigns, either in support of or opposition to a political candidate (See V. "Lobbying and Political Activities");

(b) Social welfare organizations have a very limited ability to attract tax-deductible charitable contributions;

(c) Social welfare organizations, unlike private foundations, are not subject to a 2% excise tax on net investment income, (including capital gains) or to excess business holdings restrictions;

(d) Social welfare organizations are not subject to certain operational restrictions imposed on private foundations, such as mandatory minimum distributions.

V. Lobbying and Political Activities by Section 501(c)(3) and 501(c)(4) Organizations

Political Campaign Activities. The prohibition against participation by either a 501(c)(3) public charity or private foundation in a political campaign either on behalf of or in opposition to a political candidate ("electioneering") is absolute. In contrast, a section 501(c)(4) social welfare organization may engage in electioneering so long as its "primary" activity is promotion of social welfare

Lobbying Activities - 501(c)(4) Social Welfare Organizations. A social welfare organization may engage in an unlimited amount of legislative lobbying so long as the subject matter of such lobbying is related to its exempt purpose.

Section 501(c)(3) Organizations. "No substantial part" of the activities of a section 501(c)(3) organization may consist of "carrying on propaganda, or otherwise attempting to influence legislation." If an organization devotes more than an insubstantial part of its activities to lobbying it does not qualify for exemption under section 501(c)(3).*

Private Foundations. Section 501(c)(3) private foundations, with very limited exceptions, are not permitted to engage in any legislative lobbying activities. There are three important exceptions to the ability of a private foundation to engage in direct or grassroots lobbying:

* The substantial part determination is made using one of two tests. It is based on all the facts and circumstances of a particular case or the expenditure test of sections 501(h) and 4911 which is based on expenditures associated with particular activities. An organization that has not made the section 501(h) election to have the substantiality of its lobbying activities determined under the expenditure tests, is subject to the substantial part test.

1. Lobbying that constitutes making available information containing nonpartisan analysis, study or research, that are directed to legislators and the public to enable the formation of an independent opinion. (For example, examination and discussions of broad social and economic problems are excluded from the definition of lobbying.);

2. Technical assistance that is provided to a governmental body or committee in response to a written request and;

3. Lobbying to influence proposed legislation that could affect the powers and duties of the foundation, its existence or its tax exempt status.

A private foundation will not be subject to excise tax or otherwise jeopardize its exempt status if a grantee uses grant funds for expenditures which the foundation is prohibited from making, so long as funds are not "earmarked" for the prohibited activities.

Substantial monetary penalties for violation of Code section 4945 restrictions against lobbying may be imposed on the foundation, as well as its managers. The initial tax on the organization is equal to 10% of the amount expended, and the second tier tax, equal to 100% of the amount involved, may be impose if the violation is not "correct" in a timely fashion.[2]

VI. EVALUATION OF THE PREMERA CONVERSION PLAN

The Premera Conversion Plan as it regards the formation and use of new nonprofit organizations to accept and deploy the economic value created for the benefit of the public by the conversion of Premera from nonprofit to for-profit status attempts to strike a balance among at least three competing concerns – tax efficiency, simplicity and public confidence.

This model would result in the formation of a single Washington nonprofit corporation to receive the State of Washington's share of the stock of New Premera; to participate in an initial public offering ("IPO") of such stock; and, to use the proceeds from the IPO to promote the health of the residents of the State of Washington. (The model would also result in the formation of a single Alaska nonprofit corporation to serve the same functions and purposes with respect to Alaska's share of the stock of New Premera.)

This model would capture most, if not all, of the federal tax advantages that are likely to be material to the interests of the State of Washington and its residents. Specifically, the proposed WA Foundation is designed to qualify for federal tax purposes as a "social

[2] The first level tax on a manager who knowingly approved the expenditure is equal to 2-1/2% of the amount involved, with a $5,000 ceiling, and the second tier tax is 60%, with a $40,000 ceiling. Managers are not subject to the tax if their participation was not wilful and was due to reasonable cause. In addition, if more than one person is liable for making a taxable expenditure, all such persons are jointly and severally liable. I.R.C. §4945(b) and (c).

welfare organization" described in section 501(c)(4) of the Code. If the IRS determines that the WA Foundation is so described, no federal income tax would apply to the WA Foundation's receipt and subsequent sale of its share of the stock of New Premera. Moreover, no federal income tax would apply to any dividends, interest, rents, royalties or gains earned by the Foundation from investing the proceeds from the sale of the stock of New Premera.

In addition and because the WA Foundation would not be subject to possible classification for federal tax purposes as a "private foundation," no federal excise tax would apply to the "net investment income" of the Foundation, including the gain from the sale of the stock of New Premera. Nor would any other requirements, restrictions or excise taxes generally imposed on "private foundations" be applicable to the Foundation or its operations. Finally, as a "social welfare organization" described in section 501(c)(4) of the Code, the Foundation would be subjected to comparatively minimal annual federal tax information reporting.

On the other hand and as a general rule, as an organization described in section 501(c)(4) of the Code the Foundation would not qualify to receive federally tax deductible charitable gifts or bequests from would-be donors. The Foundation could not utilize tax exempt bonds as a means of borrowing funds. Federal Unemployment Tax would be applicable to wages paid to employees of the Foundation. The Foundation may not qualify to receive certain governmental grants that require the grantee to be an organization recognized as described in section 501(c)(3) of the Code. And, many third party private foundations may not be able to, or comfortable with, providing grants to the Foundation or partnering with the Foundation on projects of joint interest.

The Foundation model that is proposed by the most recent Premera Conversion Plan would achieve simplicity in that to accomplish the primary objectives of the Plan (as such objective relate to maximizing the ability to use the funds derived from the conversion to promote the health of the residents of Washington and Alaska) it requires the formation, maintenance and operation of a single traditional Washington nonprofit corporation and a single traditional Alaska nonprofit corporation.

The Foundation model that is proposed by the most recent Premera Conversion Plan is structured to achieve public confidence in three ways. First, the fact that it utilizes only one Washington entity and that such entity is organized under Washington's nonprofit corporation statute should inspire confidence by reason that the corporate mechanics are straight forward. Second, the fact that the proposed Articles of Incorporation and proposed By-Laws of the Washington nonprofit corporation have been crafted to include many provisions (such as limitations on lobbying activities) required of organizations seeking IRS recognition of status as described in section 501(c)(3) of the Code should inspire confidence by reason of the fact that there are standards required in the operation of the Foundation that are enforceable under State law. Finally, the fact that the Foundation intends to seek and obtain formal Internal Revenue Services recognition that it is and will continue to satisfy the requirements of an organization described in section 501(c)(4) of the Code should inspire confidence by reason of the fact that there is and

will continue to be significant oversight of the Foundation and its activities by the federal government.

VII. Recommendations Regarding Proposed Conversion Plan Documents

As noted above, for federal tax purposes it would be more advantageous for the Washington Foundation to be recognized by the IRS as a "social welfare organization" described in section 501(c)(4) of the Code as opposed to a "charitable private foundation" described in sections 501(c)(3) and 509(a) of the Code. There are more similarities than differences between the definitional requirements of a "social welfare organization" and a "charitable private foundation" and it is the responsibility of the IRS to, among other things, determine which definition more closely fits the facts, circumstances and descriptions provided by an applicant for an exemption determination. Thus, the following comments and recommendations are submitted with a view to strengthen and support the position that the WA Foundation should be recognized by the IRS as a "social welfare organization" described in section 501(c)(4) of the Code:

A. Articles of Incorporation of The Washington Foundation Shareholder – Exhibit E-1(a)

1. Regarding the Foundation's "purposes" at Article III, Section 1(c), consideration should be given to eliminating the word "low-income." The use of such a term conveys a sense of a "charitable" purpose more than a "social welfare" purpose.

2. Regarding the Foundation's "powers" at Article III, Section 2, consideration should be give to expanding the power of the Board of Directors to be able to directly or through contributions accomplish or support any activity that would promote the health of the residents of the State, including by way of making contributions to charitable organizations. As proposed, the power may not be construed to include accomplishment of more than "charitable" purposes.

3. Regarding limitations and conditions imposed on lobbying at Article IV, Section 5, consideration should be given to eliminating the restrictions against using any proceeds from the sale of the stock of New Premera for lobbying and using any other resources of the Foundation to lobby on matters that may result in material adverse changes in the operations of Health Insurers. The inclusion of these restrictions in the Foundation's governing instrument may give rise to questions regarding the influence of Premera/New Premera over the affairs of the Foundation. As an alternative, it is suggested that, as part of the Plan (possibly, in the Transfer, Grant and Loan Agreement) New Premera impose these

restrictions as a condition of its grant of the stock of New Premera to the Foundation and that the initial Board of Directors of the Foundation agree, on behalf of the Foundation, to accept such conditions.

4. Regarding the "dissolution" of the Foundation at Article XII, consideration should be given to expanding the possible class of organizations to which the net assets of the Foundation may be paid to upon dissolution include social welfare organizations described in section 501(c)(4) of the Code as well as charitable organizations.

B. Bylaws of Washington Foundation Shareholder - Exhibit E-2(a)

Regarding compensation of Directors and reimbursement of their expenses at Article III, Section 3.11, consideration should be given to adding the word "reasonable" after the word "necessary" and before the word "expenses" on the last full line.

C. Form A Statement

Regarding the description of "Future Plans of the Insurer" at Item 5, second paragraph, consideration should be give to: (a) changing the phrase "charitable foundation" in the first sentence to "social welfare organization;" and, (b) to deleting the phrase "gradually divest of their stock of New Premera over a period of time and use the resulting proceeds" in the second sentence and replacing it with the phrase "use the proceeds from the divesture of their stock of New Premera." In addition it is recommended that the last sentence in the paragraph be deleted and the following sentence be inserted in its stead: "In any event, each of the Washington Foundation Shareholder and the Alaska Health Foundation shall be responsible for any federal excise taxes that may be imposed on its net investment income as the result of its disposition of stock of New Premera."

D. Diagram of Premera Conversion Transaction – Exhibit A-3(a)

Regarding the descriptions of the WA and AK Foundations in "Step A explanation to the Diagram," consideration should be given to deleting the phrase "and to administer charitable uses of such proceeds" and inserting in its stead the phrase "to promote the health of their respective residents."

VIII. Reasons Why the Premera Conversion Plan May Be Disadvantageous

If tax certainty is an important objective to be achieved, one of the disadvantages of the Premera Conversion Plan is that there is no way to be sure that the Washington Foundation (or the Alaska Foundation) will be recognized by the Internal Revenue Service as exempt from federal tax by reason of being described in section 501(c)(4) of

the Code without establishing the Foundation and obtaining Internal Revenue Service recognition of its tax status before implementation of the Plan of Conversion. In many, if not most, cases it is possible to predict with reasonable certainty whether the Internal Revenue Service will rule favourably on a request that an organization be determined to be described in section 501(c)(4) of the Code. (Moreover, absent unusual facts and circumstances, the effective date in the event of a favourable determination relates back to the date that the organization is formed under applicable state law.)

In this case and in light of the significance of the resulting tax consequences, it is not possible to predict with reasonable certainty whether the Internal Revenue Service would rule favourably because the governing instruments of the Foundation contain provisions (such as limiting to "insubstantial" its ability to engage in lobbying activities) that more closely satisfy the technical requirements of an organization described in section 501(c)(3) than one described in section 501(c)(4) of the Code. In this regard, it should be noted that the applicable provisions of the Code do not make this selection process discretionary. Rather, the applicable provisions require that an organization so described "shall be" exempt by reason of satisfying one definitional requirement or another. In this case, significant tax differences result from the determination that the Foundation is described in section 501(c)(4) as opposed to section 501(c)(3). Accordingly and even though it is probable that the Internal Revenue Service would rule favourably that the Foundation is described in section 501(c)(4) of the Code, it would be prudent to delay transferring the stock of New Premera to each Foundation until it has received a definitive favorable determination. Even though procedures are implemented to expedite this process it is likely to take at least three months and could take twelve months or longer from the date a formal request to obtain such determination.

Certain other tax disadvantages to the Premera Conversion Plan as it relates to the roles of the Washington Foundation and Alaska Foundation are discussed in detail at Part VI above. In summary, these disadvantages relate to the fact that applicable federal tax law makes several potentially significant tax benefits available to organizations describe in section 501(c)(3) that are not available to organizations described in section 501(c)(4), the type of exempt tax status that the Foundation intends to seek under the Plan.

IX Alternatives to the Premera Conversion Plan

A Solely a 501(c)(3)

Establishing the proposed Washington Foundation to achieve a determination by the Internal Revenue Service that it is an organization described in section 501(c)(3) of the Code (as opposed to section 501(c)(4) of the Code) is a possible alternative to the Premera Conversion Plan. The potential tax advantages to this alternative are likely not significant whereas the resulting tax disadvantages are significant.

Specifically, several of the tax disadvantages of utilizing a section 501(c)(4) organization (such as its inability to attract on a tax favourable basis to the donor charitable gifts and bequests or to utilize tax exempt financing) would be available were the Foundation to be determined to be described in section 501(c)(3) of the Code. Moreover, with very minor modifications, it may be easier to predict with certainty that the Internal Revenue Service would issue a favourable determination of section 501(c)(3) status. However, the resulting tax disadvantages far outweigh the potential tax advantages. Specifically and significantly, as an organization described in section 501(c)(3) the Foundation would almost certainly be classified as a "private foundation." In turn, this would subject the gain (likely to be the net sale proceeds) from the sale of the Foundation's share of the stock of New Premera to federal excise tax (at a rate as high as 2%). It would also subject all of the investment income of the Foundation earned by investing the proceeds from the sale of the New Premera stock to this same federal excise tax. In addition, the Foundation would be subject to many limitations and restrictions imposed by the Code on "private foundations" (including the requirement that it make annual mandatory qualified distributions) as well as annual federal tax reporting responsibilities significantly greater than those imposed on a section 501(c)(4) organization.

There would be two potential advantages that are only indirectly related to tax classification. The first is the fact that many more organizations formed as the result of "Blues Conversion" type transactions have selected to be section 501(c)(3) than have selected to be section 501(c)(4) organizations. Thus, the WA Foundation from a tax classification perspective would be categorized with the majority of its peers. The second potential advantage is that public perception may be more favourable as it regards the likelihood that the Foundation would be more accountable and transparent if it is required to maintain the more closely IRS scrutinized standards of section 501(c)(3) "private foundation" status.

B. Two Tier Plan

The only advantage to be obtained by utilizing a two tier plan (as was originally proposed by Premera) is to achieve many of the advantages of a single section 501(c)(3) plan and also avoid the imposition of a federal excise tax (at a rate as high as 2%) on the gain (likely to be the net proceeds of sale) from the sale of the Washington Foundation's share of the stock of New Premera.

There are numerous disadvantages to this alternative plan as described in our original report.

X. Healthcare Conversion Transactions in Other States: Lessons Learned

Most foundations established as a result of health plan or system conversions are 501(c)(3) private foundations. (See "A Profile of New Health Foundations" chart in I., "Executive Summary.") Several health conversion organizations are recognized as social welfare organizations pursuant to section 501(c)(4), but almost without exception, they operate with many section 501(c)(3) restrictions in their by-laws, either as required by state statute or as adopted by their boards (often at the behest of the governor or attorney general of the state). A few conversion organizations are structured as section 501(c)(3) public charities by reason of qualifying as a supporting organization as defined by section 509(a)(3).

No recognized body of law provides an infallible bright line test for distinguishing clearly between a 501(c)(3) and 501(c)(4) organization. Thus, even though other states have experience in structuring health conversion foundations as 501(c)(4) social welfare organizations with certain 501(c)(3) restrictions contained in their by-laws (e.g., limits on lobbying activities), the risk is not eliminated or even necessarily diminished that the IRS could determine that such a health care conversion foundation is, in fact, a 501(c)(3) private foundation, not a 501(c)(4) social welfare organization. Thus, the only way to achieve certainty is to obtain a formal determination from the IRS based on a submission of all of the relevant facts and circumstances.

State attorneys general and insurance commissioners are exercising more stringent regulatory review of proposed conversions (strengthened by the enactment of state conversion statutes). They are ensuring the protection of charitable assets and the historic nonprofit purposes of health plans. Essential to this protection is making objective determinations about the receipt of fair market value and the consequences of the conversion on healthcare delivery to citizens of the state. State attorneys general have filed lawsuits not only to set aside the full value of conversion proceeds for charitable use, but to maintain and protect the charitable assets from distribution to out-of-state charitable conversion foundations by health systems merging and acquiring other plans in other states. Lengthy public comment periods, intervention by consumer groups and professional organizations, and public hearings with testimony by independent experts retained by the state are common. In 2002 and 2003, the insurance commissioners in

Kansas and Maryland refused to approve healthcare conversion transactions because they were "not in the public interest".

Consumer health advocates also have successfully demanded greater public engagement, not only during the conversion review process, but also with respect to decisions concerning the resulting charitable foundation's structure, mission, governance and board independence, and ongoing grant making operations. Whether a 501(c)(3) private foundation or public charity, a 501(c)(4) social welfare organization or a 509 (a)(3) supporting organization is chosen as the charitable structure, governance that ensures accountability, independence, and transparency is increasingly judged as best practice. As noted previously, many organizations structured to qualify as 501(c)(4) organizations have adopted by-laws imposing 501(c)(3) private foundation restrictions. (California, North Carolina, Colorado, Maine and Ohio have statutes requiring health conversion 501(c)(4) organizations to adopt such restrictions.) The power to appoint board members, board independence and composition, and the role of community advisory committees have emerged as critical issues. Consensus about model by-laws and governance, as well as best practice in mission and charitable grant making for health care conversion foundations has begun to develop.

A review of the conversion transaction histories in other states, including California, reveals that the two-tier structure originally proposed by Premera (whereby a Foundation Shareholder would be established as a 501(c)(4) organization to, among other things, receive and monetize the New Premera Shares, and then distribute share proceeds to two charitable trusts, organized as section 501(c)(3) private grant making foundations) appears to be in the minority, if not, as contemplated, unique. Choice of tax status is revocable, and a few healthcare conversion foundations have sought to change their tax status successfully after gaining experience in philanthropy.

Conversion Transaction Histories

California	BCC transferred a majority of its assets to a for-profit sub, WellPoint Health Networks, Inc. in 1993 without formal charitable distribution. Negotiations with Department of Corporations ensued, resulting in BCC's agreement to distribute all of its assets, $3.2 billion, to two newly-formed charitable grant making organizations, the California Endowment, a 501(c)(3) private foundation and the California Healthcare Foundation, a 501(c)(4) social welfare organization (designed to spend down its assets in contrast to the Endowment). In 1996, pursuant to a recapitalization by and among WellPoint, BCC and the two nonprofits, the 501(c)(3) Endowment received a donation of $800M in cash from BCC, BCC's portion of a special $10.00 per share dividend distributed to shareholders of WellPoint common stock. The 501(c)(4) Healthcare Foundation received a donation of equity which converted into new WellPoint common stock following conversion of BCC to for-profit status and its subsequent merger with WellPoint. Independent consultants were retained to determine valuation and the mission, governance and structure of the foundations. Board selection for the endowment was applauded as extremely thorough and fair, using a consortium of executive of executive search firms.
Colorado	BCBSCO filed a proposal to convert in 1997 after merging with BCBS of Nevada, proposing to distribute 100% of its stock of the holding company to two 501(c)(4) foundations. Following a public comment period, the plan proposed to distribute net proceeds of public offering to one 501(c)(3) foundation. Consumer groups intervened and hearings to determine mission, governance, and structure occurred in 1997, resulting in the establishment of The Caring for Colorado Foundation, a 501(c)(4) with a community advisory committee and certain by-laws adopting restrictions characteristic of a 501(c)(3). Thereafter, BBSCO agreed to affiliate with Anthem and after negotiations (and bids from WellPoint), Anthem agreed to pay $155M, contributing $140M to the Caring for Colorado Foundation. The Governor, the Insurance Commissioner and consumer groups negotiated the power to appoint the Board of Directors and the degree of community representation on the Board. In February 2001, Anthem filed its demutualization plan in Indiana. It was approved in October 2001 when Anthem launched its IPO.
Connecticut	In July 1997, the Department of Insurance approved the merger of BCBSCT (a mutual insurer since 1984) with Anthem Insurance Companies. The Attorney General named a Special Attorney General, recusing his office from considering the charitable trust issues in the merger. In 1997, the state comptroller and a coalition of advocacy and labor organizations filed separate suits against Anthem to protect policyholder rights and to preserve charitable assets now possessed by Anthem. The Special Attorney General also filed a suit to prevent Anthem from acquiring and transferring out of Connecticut assets subject to a charitable trust, alleging that Anthem and BCBSCT breached their fiduciary duties by refusing to maintain the assets of the BCBSCT plan for charitable purposes. In June 1999, Anthem settled the litigation, agreeing to transfer approximately $41 million to the Anthem Foundation in Connecticut. To ensure community and consumer representation the state established the Connecticut Health Advancement and Research Trust (CHART), a 501(c)(3), with the power to appoint the Anthem Foundation board. The new Anthem Foundation is incorporated as a 509 (a)(3) supporting organization to CHART. The Connecticut Health Foundation, originally established as a 501(c)(4) organization with certain 501(c)(3) restrictions incorporated in the by-laws, converted to a 501(c)(3) private foundation in July 2002 at the behest of the Attorney General.

Georgia	In May 1996, Georgia BCBS filed for conversion and established itself as a privately held for-profit company, Cerulean Companies, Inc. The transaction was approved without any assessment of the plan's charitable trust obligations. Class action lawsuits followed and on July 8, 1998, the plaintiffs and Cerulean/BCBSGA reached a settlement resulting in the transfer of $70-$80 million to a new charitable foundation with board members designated by plaintiffs, Cerulean BCBSGA and prominent nonprofit organizations. Well-point Health Networks subsequently purchased Cerulean and litigation ensued, resulting in a higher offer from WellPoint. In March 2001, the Georgia Insurance Commission approved the acquisition which increased the foundation's endowment to $124 million.
Kansas	After litigation during 1998 and 1999 between BCBSK, the Attorney General, and the insurance commissioner concerning whether BCBSK had a charitable trust obligation to the people of Kansas and whether it had breached its fiduciary duty by using substantial corporate assets in an attempt to merge with BCBS-KC, the court found in January 2000 that BCBSK possessed charitable assets. In August 2000, the Attorney General, the Insurance Commissioner and BCBSK reached a settlement, creating a new foundation, the Sunflower Foundation, a 501(a)(3) supporting organization to which BCBSK contributed $75 million. Consumer groups, initially very positive with the settlement, questioned the Kansas Attorney General's unique decision to establish the foundation as a supporting organization to the Kansas Attorney General's office, rather than as an independent 501(c) (3) private foundation. Advocates were concerned that the foundation might be vulnerable to undue political influence in the future. After considering whether to challenge the Attorney General for overreaching her authority, the state legislature amended the Kansas Open Records Act to apply its sunshine provisions specifically to the Sunflower Foundation. In May 2001 BCBSK and Anthem Insurance Companies announced their plans to affiliate in a sponsored demutualization, providing $370 million to BCBSK ($190 million for BCBSK's outstanding expenses and $180 million to policyholders). After the Insurance Commissioner retained independent financial and economic health experts, convened a four month public comment period and several days of public hearings, including testimony analysing likely premium increases of over $248 million over five years for individuals and small groups, Anthem added a $25 million rate stabilization fund. In February 2002, the Insurance Commissioner rejected the proposed conversion, finding it to be unreasonable to policyholders, "not in the public interest", and "hazardous and prejudicial to the insurance buying public." BCBSK appealed the Commissioner's ruling to the County District Court that had vacated the Commissioner's order in June 2002, finding she had exceeded her authority. The Commissioner appealed the case to the Kansas Supreme Court and on August 5, 2003, the Court ruled in favor of the State, preserving the ruling by former Insurance Commissioner (and now, Governor) Kathleen Sebelius, who vetoed the conversion and sale. In research conducted by her office, the then-commissioner found that the largest premium increases would fall on small business owners and their employees and residents with individual Blue Cross insurance policies. An independent analysis by PricewaterhouseCoopers also concluded that Anthem would need to raise premiums by 7% for these two groups in order to achieve a 2.5% increase in profits.

Kentucky	In a 1993 merger between Anthem Insurance Companies and Kentucky BCBS, the Kentucky Insurance Commissioner approved the transaction without any consideration of BCBSKY's charitable assets. After a routine investigation by the Department of Insurance in 1996 raised questions about Anthem's use of reserves, the Attorney General filed a lawsuit against Anthem seeking to recover millions of dollars in charitable assets and reimbursement of premium increases. After several years of litigation, the Attorney General and Anthem announced a settlement of the charitable trust issue in December 1999 when Anthem agreed to place $45 million into a newly created 501(c)(3) foundation. During the interim period, the $45 million was held in an interest bearing state governmental trust account. The members of the advisory board were appointed by the Franklin Circuit Court upon nomination by the Attorney General and were charged with making recommendations to the Court about the structure and composition of the new foundation. Subsequently, in early 2000, the Kentucky General Assembly began a legislative effort, challenging the enforcement authority of the Attorney General and the power of the Court's jurisdiction over the charitable assets, seeking to establish the foundation as a "quasi-governmental entity". Over 40 consumer and philanthropic groups urged the Governor to veto the legislation, which he signed into law in April 2000. A 35-member community advisory committee was appointed by the Governor to set up the foundation. In June 2001 Anthem filed its demutualization plan with the Indiana Department of Insurance providing policyholders in some states with shares in the new company but not policy holders in Colorado, Maine, New Hampshire or Nevada.
Maryland, Delaware, District of Columbia	On March 5, 2003, the Maryland Insurance Commissioner announced his decision to deny the application by non-profit Blues plan, Carefirst, to convert and be acquired by WellPoint. Carefirst is the holding company controlling BCBS plans in Maryland, Delaware and the District of Columbia. Because Carefirst is the Blues insurer in D.C. and Delaware, review and approval of the proposal was required in those jurisdictions as well. In 2002, the D.C. Insurance Commissioner held public forums but has indicated that if the Maryland decision were upheld, he would not continue to review the proposal. WellPoint had asked the Delaware Insurance Commissioner to put her review on hold. The Maryland Insurance Commissioner, after contracting with four experts and conducting five public hearings, determined that the conversion was not "in the public interest", citing the violation by Carefirst's Board of its fiduciary duties by failing to upheld its non-profit mission and to conduct appropriate due diligence in deciding whether to sell the plan. He concluded the Board's approval of unreasonable compensation packages for executives constituted a violation of the conversion statute and dismissed the argument that Carefirst needed greater access to capital funding, ruling that Carefirst is "financially stable" and that "data clearly support the notion that bigger is not normally better." A few days following this decision, legislation was introduced in the Maryland General Assembly to make Carefirst a more responsible nonprofit organization by changing certain board members, stating its charitable mission in the statute, preventing conversion to for-profit status for five years, and establishing certain other requirements for the nonprofit. Passed on April 7, 2003, it later received the Governor's approval. The Blue Cross Blue Shield Association then acted to revoke CareFirst's license to use the name and mark and litigation followed. A compromise was reached reducing the extent to which state officials selected replacement directors. State and federal investigations arising from the failed conversion continue.

Missouri	After several years of litigation arising out of the 1994 conversion of BCBSMO to the for-profit Right Choice, the Missouri Foundation for Heath was created as a 501(c)(4) organization in 2000 pursuant to a settlement agreement among BCSBSMO, the Attorney General and the Department of Insurance. In November 2000, the Foundation received almost $13 million in cash and 15 million shares (80%) of the common stock of RightChoice Managed Care of St. Louis (worth approximately $400 million at the time). In 2001 WellPoint purchased RightChoice, increasing the value of the Foundation's endowment to nearly $1 billion upon the completion of the RightChoice merger in 2002. The Foundation is a 501(c)(4) but has adopted by-laws containing many 501(c)(3) restrictions.
New Hampshire	In January 1999 Anthem Insurance Companies announced its plan to acquire BCBSNH for $120 million and to fund a newly-created 501(c)(3) charitable health foundation, the Endowment for Health, Inc, with $83 million of the sale proceeds. The non-profit BCBSMA also bid, filing papers with the new Hampshire Attorney General arguing that the common-law standard of dissolution of a non-profit corporation had not been met by Anthem in its proposal because a viable option existed that would enable BSBCNH to continue as a non-profit through affiliation with the nonprofit Massachusetts plan. After a series of seven public hearings in 1999 concerning the plan for the health foundation, the Attorney General approved the proposed charitable trust plan, which was challenged in Probate Court by consumer groups unsuccessfully. After a 3-day public hearing on the proposed sale, the Department of Insurance approved the sale of BCBSNA to Anthem in October 1999, imposing 18 conditions on the new company, including: 1) creating a local advisory board to be consulted before significant business changes including levels of service coverage and employment are made, 2) maintaining community benefits and health coverage for lower income individuals, 3) maintaining provider network comparable to BCBSNH and 4) reporting verbal and written complaints received to the Department of Insurance.
New York	In 1997 Empire BCBS filed conversion documents, having agreed to transfer $1 billion of its charitable assets to a nonprofit foundation. After a series of public meetings, the Greater New York Hospital Association and 1199/SEIU union expressed interest in taking over Empire. Empire rejected the proposal. In 1999, the New York Insurance Department held three public hearings on the conversion and approved certain aspects over which the Department had jurisdiction. In May 2000, after a year of negotiations with Empire, Attorney General Spitzer approved the valuation and foundation aspects of the conversion plan. In June 2000, after six years of opposing the conversion, the Greater New York Hospital Association and 1199/SEIU approved it when Empire offered to give half of the $1 billion in charitable assets to both groups. In January 2002, the state legislature passed a bill sought by Governor Pataki, reallocating 95% of the charitable assets to fund salary increases of 13% for 1199/SEIU employees over three years, preserving 5% of the funds for a small foundation dedicated to expanding health coverage. In August 2002, several consumer groups filed a lawsuit to block the conversion on the grounds that the state legislation authorizing it is unconstitutional. The Court dismissed the claims but outlined another viable constitutional claim: that the legislation violated New York's constitutional prohibition on "private" laws, defined in New York as legislation designed to benefit a single company. Plaintiffs have appealed the court's dismissal of their original claims and asserted, at the Court's invitation, the private-law constitutional claim. The state has cross-appealed.
Ohio	In late 1995, Community Mutual Insurance, one of two BCBS Ohio plans, merged with Anthem Insurance Companies with the approval of the Department of Insurance. In July 1996 the Attorney General initiated an investigation to determine whether charitable assets involved in the transaction should have been protected. After resisting pressure from community groups to open the investigation for public review, the Attorney General and Anthem reached a settlement in 1999. Anthem agreed to contribute $28 million to the Anthem Foundation, a newly-created healthcare foundation incorporated as an (a 509 (a)(3) supporting organization. Local community groups criticized the public process, the structure and governance of the foundation, the assumption to value only the Blue Cross assets and the misleading name of the foundation. In February 2001 Anthem filed its demutualization plan in Indiana, which was approved in October 2001, followed by the Anthem IPO.

The information provided in this chart is compiled by a nonprofit organization, Community Catalyst, which tracks health conversion and health issues in all states (see www.Communitycat.org).

XI. Other Issues

A. Unallocated Shares

In the event that Alaska and Washington do not agree on allocation of all or any portion of the stock of New Premera between the Foundations, or having agreed, New Premera is precluded from delivering such stock to the Foundations, the Foundations propose to agree that New Premera will deposit the so-called Unallocated Common Shares with an Unallocated Shares Escrow Agent to be held and administered under an Unallocated Shares Escrow Agent Agreement. The Unallocated Shares Escrow Agent is directed by the Agreement to release the Unallocated Common Shares and any proceeds from the sale thereof, and investment income thereon as invested and reinvested, to the Foundations upon receipt of instructions jointly signed by the Foundations' respective duly authorized representatives, and delivered to New Premera and the Unallocated Shares Escrow Agent. Upon receipt of jointly written instructions from the Foundations regarding allocation of the Unallocated Common Shares, the Escrow Agent is further instructed to deliver the certificate(s) representing the Unallocated Common Shares to New Premera for reissue in appropriate amounts pursuant to such agreed allocation. So long as held under the terms of the Agreement, the Unallocated Shares Escrow Agent is deemed to be the record holder of all Unallocated Common Shares.

The Escrow Agent is required by the Agreement to hold all dividends on the Unallocated Shares for the benefit of the Foundations. In the event of liquidation of New Premera the Escrow Agent is directed to distribute any assets received attributable to the Unallocated Shares (net of costs and expenses) to the Foundations in accordance with mutually agreed upon written instructions. In the absence of agreement between the Foundations, the Escrow Agent may seek resolution of ownership as between the Foundations by instituting a bill of interpleader in a court of competent jurisdiction. To the extent that New Premera stock is sold by the Escrow Agent the resulting funds and any earnings thereon (net of costs and expenses) are to be distributed to the Foundations as they shall agree and otherwise as may be determined by a court of competent jurisdiction.

The Agreement states that neither New Premera, nor the Escrow Agent, shall have any tax obligations with respect to: dividends on the Unallocated shares; sale of the Unallocated Shares; investment income derived from reinvestment of proceeds from the sale of Unallocated shares; or any distributions from the Escrow to the Foundations.

It is not clear for federal tax information reporting purposes how the activities of the Escrow Agent with respect to the Unallocated Shares should be annually

reported by either Foundations or the Escrow Agent. While it would appear that the Escrow Agent should not be treated as taxable on any income derived from or in connection with the Unallocated Shares, it may be necessary to seek and obtain formal confirmation of this conclusion from the IRS and formal guidance regarding the appropriate way the parties should report the activities of the Escrow Agent with regard to the Unallocated Shares and funds derived therefrom.

B. State and Local Tax Matters

In general, each state in which assets are held or business is operated by an organization has a vested interest in the taxation of corporate reorganizations. Thus, it would be prudent to consider whether any tax imposed by either Washington, Alaska or any of either state's political subdivisions may be applicable so as to reach the assets, income or operations of the WA Foundation or the AK Foundation. It is important to note that a state's tax laws may not follow federal income tax treatment (and could impose taxes on an otherwise federal income tax exempt or deferred transaction). Some states also have established procedures for sellers (or "transferors") to obtain tax certificates of good standing ("Tax Clearance Certificates") prior to a proposed transaction, wherein the state will certify the transferor's total liability for sales and income taxation. A state may also have local jurisdictions imposing certain taxes on a corporate reorganization (e.g., property taxation). A transferee of property in a corporate reorganization should consider any transferee liabilities (e.g., income, sales, payroll, etc.) assumed under federal, state and local tax jurisdiction in connection with property acquired. These issues should be further analyzed to determine whether there are specific issues regarding material potential tax exposure and, if so, whether there is a mechanism (e.g. ruling process) to eliminate uncertainty.

C. Tax Reporting Matters

1. Form 990 vs. Form 990-PF

Private foundations are subject to a comprehensive regulatory scheme designed, in part, to provide greater accountability for private foundations and persons controlling them. The regulations and reporting responsibilities imposed on section 501(c)(3) public charities are significantly less than those imposed on private foundation. The regulations and reporting responsibilities imposed on section 501(c)(4) social welfare organizations are significantly less than those imposed on section 501(c)(3) public charities. Thus, a social welfare organization described in section 501(c)(4) generally is required to file annually with the Internal Revenue Service a Form 990, Return of Organization Exempt

From Income Tax. A section 501(c)(3) public charity is required to file a Form 990 and a Schedule A, Organizations Exempt Under Section 501(c)(3), and possibly a Schedule B, Schedule of Contributions. A private foundation must file an even lengthier annual return on Form 990-PF, Return of Private Foundation. In each case, these forms must be filed with the Internal Revenue Service by the 15th day of the 5th month – not including extensions – following the close of the organization's accounting period. Federal rules also require private foundations to forward the Form 990-PF to any state: (i) in which the principal office of the organization is located, (ii) the organization was incorporated or created, (iii) to which the organization reports in any fashion concerning its organization, assets or activities, or (iv) with which the organization has registered (or which it has otherwise notified in any manner) that it intends to be, or is, a charitable organization or a holder of property devoted to a charitable purpose.

Form 990, Schedule A, Schedule B & Form 990-PF generally require the following information:

(i) general financial information, including its gross income, expenses, disbursements for exempt purposes, and beginning-year balance sheet;

(ii) identification of total contributions and gifts received along with the names and addresses of all substantial contributors;

(iii) disclosure of the names and addresses of its officers, directors, trustees, and key employees (including the details of compensation and other payments made to each of these individuals);

(iv) certain information in connection with lobbying efforts and transfers to exempt and political organizations; and

(v) additional information in connection with certain taxes as those applicable to lobbying and political expenditures and expenditures to influence legislation.

Private foundations must disclose additional information on Form 990-PF, such as:

(i) an itemized statement of its securities and all other assets, including their values;

(ii) an itemized list of all grants and contributions, including the name and address of the recipient and a concise statement of the purpose of each such grant or contribution; and

(iii) additional information applicable to excise taxes imposed on the private foundation's net investment income.

D. Public Disclosure Requirements

Annual Return and Exemption Application. An exempt organization, whether a social welfare organization, a public charity, or a private foundation, must make available for public inspection, upon request and without charge (except for copying costs), an exact copy of its original and amended, if any, three most recent year's annual information returns (e.g., Form 990, and where applicable, Schedule A or Form 990-PF), and certain schedules, attachments, and supporting documents filed with the Internal Revenue Service. In addition, the exempt organization must also make available for public inspection without charge its application for federal income tax-exempt status (either IRS Form 1023 or Form 1024), which generally includes the application form, all documents and statements the Internal Revenue Service requires the organization to file with the form, any statement or other supporting document submitted by an organization in support of its application, and any letter or other document issued by the Internal Revenue Service concerning the application.

XII. Caveats and Limitations

The aforementioned analysis in our report is based upon certain procedures approved by the OIC and performed by PricewaterhouseCoopers. The OIC is responsible for the sufficiency of the procedures as well as for drawing conclusions with respect to PwC's findings.

We make no representation regarding the sufficiency of our work either for purposes for which this report has been requested or for any other purpose. The sufficiency of the work we performed is solely the responsibility of the OIC, as are any decisions with respect to the proposed transaction. Had we been requested to perform additional work, additional matters might have come to our attention that would have been reported to you.

It is understood that this report is solely for the information of the OIC. PricewaterhouseCoopers' findings may be included in whole or in part in the record upon which any regulatory determination may be made by the OIC, which PricewaterhouseCoopers understands may be a matter of public record. If the OIC chooses to name PricewaterhouseCoopers in any report, the OIC should disclose that PricewaterhouseCoopers is not responsible for the sufficiency of the procedures for the purpose of the OIC's evaluation of the proposed transaction. PricewaterhouseCoopers' report will be intended solely for the information and use of the OIC and is not intended to be and should not be used by anyone else.

In addition to the foregoing, this report, or portions thereof, is not to be referred to or quoted, in whole or in part, in any registration statement, prospectus, public filing, loan agreement, or other agreement or document without our prior written approval, which may require that we perform additional work.